

United States
Department of
Agriculture

Farmers
Home
Administration

Washington
D.C.
20250

FmHA AN No. 1571 (1955)

March 31, 1987

SUBJECT: Suitability Determinations and
Repair of Suitable SFH Inventory

TO: All State Directors, State Directors-at-Large,
District Directors and County Supervisors, FmHA

Purpose/Intended Outcome: To clarify the policy on suitability determinations and repair of suitable SFH inventory houses. There are indications that repairs are sometimes being considered "not economically feasible" if the difference between the "as is" and "as improved" appraisals is less than the cost of the repairs, and some properties are being improperly classified as unsuitable.

Implementation Responsibilities: State Directors and District Directors are responsible for seeing this policy is complied with. The County Supervisor is authorized to make suitability determinations (See FmHA Instruction 1955-B, paragraph 1955.63(d)).

Background Regulations: FmHA Instruction 1955-B, paragraph 1955.63(c), provides guidance on how to determine suitability of inventory property. Generally, to be determined suitable, inventory property must meet, or be brought up to meet, the same standards as an existing property to be brought into the program. FmHA Instruction 1955-B refers to FmHA Instruction 1944-A and 1924-A which set forth the program standards.

Paragraph 1955.63(c) reads in part: "Although a property can be made suitable, repairs necessary to render it so must be economically feasible. Ordinarily, the cost of repairs should enhance the value so that the return on investment will be as great or greater than it would if the repairs were not made. SFH property originally classified as suitable may be reclassified as unsuitable if physical damage occurs which is not economically feasible to repair."

Paragraph 1955.64(a)(1), as it relates to suitable property, states: "SFH inventory property which is suitable for retention in the program will be repaired, renovated, and/or improved as necessary to meet program standards for existing housing, to enhance buyer appeal, and to make the maximum recovery on the Government's investment. . . ."

Paragraph 1955.64(a)(1), as it relates to unsuitable property in the latter portion of the paragraph, states that for repairs "to be economically feasible, repairs should increase the expected 'as is' sale price by at least the cost of repairs."

EXPIRATION DATE: April 30, 1988

FILING INSTRUCTIONS: File preceding
FmHA Instruction 1955-B



Farmers Home Administration is an Equal Opportunity Lender.
Complaints of discrimination should be sent to:
Secretary of Agriculture

Interpretation: To pull together the regulations cited and to clarify and re-emphasize Agency policy, additional guidance is provided:

The suitability determination includes considering location, size, design, possible health and safety risks to occupants, and functional and economic obsolescence. Properties may be considered suitable even though the cost of repairs is more than the difference between the "as is" and "as improved" values. Considerable weight must be given to things such as:

1. Is the housing in the neighborhood suitable?
2. Is the house of a type, design and age generally considered suitable for an eligible FmHA borrower?
3. If FmHA were to determine the dwelling unsuitable, is there a potential for an investor to buy, repair, and sell it to an eligible applicant who will seek FmHA financing?
4. What impact will an "unsuitable" classification have on surrounding properties in FmHA's housing program?

If the answers to Questions 1, 2, and 3 are "yes," FmHA should determine the property suitable, make necessary repairs, and list the house for sale to applicants requesting credit on eligible terms.

Experience has shown that FmHA generally makes the best recovery on its investment by resale of suitable (program) property to program-eligible buyers. Program resales are also consistent with the intent and objectives of the housing program. Many truly suitable houses will be sold out of the program if a house is classified as unsuitable because "as-is value plus cost of repairs exceeds as-improved value." The potentially suitable house which was not repaired often does not sell readily and is held in inventory for longer periods of time than if offered with program financing. The price may be subsequently reduced administratively, or the house reappraised, and sold for substantially less than the original "as is" appraisal, compromising the validity of the suitability determination. Therefore, suitability should be determined first; and if suitable, specifications should be prepared and repairs made.

Appraising real property is an estimate of value based on comparing the subject property to other like properties and making appropriate adjustments. The appraisal of inventory property in the "as is" condition must reflect, by appropriate supportable adjustments, the value of the property in its current condition. For properties which have been determined unsuitable, the appraiser should also give consideration to types of potential financing in estimating values. Since the purchaser of unsuitable (nonprogram) property will not be obtaining program financing, the "as is" value may be substantially affected by private sector interest rates, terms, points and other related costs. The appraiser must also take into consideration repairs and improvements which will be made, bearing in mind that the cost of repairs does not always increase value dollar for dollar (cost does not create value). The final statement in paragraph 1955.64(a)(1) refers only to unsuitable (nonprogram) property.

(1571) 1955

Summary: Repairing suitable (program) property usually results in the return on investment being greater than if repairs are not made. A rigid "economic feasibility formula" which results in truly suitable houses being sold out of the program should not be used. There will, of course, be some exceptions, such as cases of extreme vandalism or other damage which would cause repairs to be excessive. In most cases, however, houses which can be suitable should be repaired and offered with program financing.



VANCE L. CLARK
Administrator